PUBLIC ACCOUNTING

INTERIM REPORT

BY

RONALD J. DANIELS

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Public accounting report : interim report

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MARCH 6, 2003

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March 6th, 2003

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Gentlemen,

I am writing to you pursuant to the mandate that the Honourable David Young, then Attorney-General and Minister Responsible for Native Affairs, conferred on me earlier in relation to the reform of public accounting regulation in the Province of Ontario. In particular, I am writing to you to set out my preliminary views on several of the matters within my mandate, and to array some of the design options that I am considering in relation to the recommendations I intend to make to the current Minister, the Honourable Norman Sterling, in the early spring.

As you know, the Government is seeking to reform public accounting regulation in the Province so as to:

- Make the practice of public accounting accessible to all chartered accountants (CAs), certified general accountants (CGAs), and certified management accountants (CMAs) who qualify.

- Set standards for public accounting that are internationally respected and that reflect the high expectations of the business community, investors and our trading partners.
- Ensure that Ontario's key trading partners, business organizations and investors continue to have strong confidence in its accounting standards to reinforce confidence in the provincial economy.

In the course of my deliberations, the Minister requested that I consult with representatives of the affected stakeholders and then make recommendations on the following matters:

- Design the changes necessary to policy, standards and legislation to make public accounting accessible to all CAs, CGAs, and CMAs who qualify.
- Develop standards that are recognized by international accounting bodies and ensure continued public and business confidence, optimum consumer protection, and institutional transparency and accountability.
- Advise on a clear definition of public accounting and the design of a framework for a professional examination that tests the core skills and competencies required to perform public accounting at a high standard.
- Recommend a structure to administer and regulate the new public accounting standards that is efficient, effective and transparent.
- Ensure that the current level and methods of access CAs have to the practice of public accounting would not be diminished by reform.

In the following document, I set out the context for the changes that the Government is interested in making to public accounting regulation in the Province. This discussion primarily focuses on the various reports that have been written for the government over the last several decades. I then briefly discuss the public interest in accounting regulation, and the various public interest criteria that can be deployed to evaluate alternative design arrangements for the regulation of public accounting. Against this backdrop, I then briefly review the structure of public accounting regulation in other jurisdictions having multiple accounting bodies whose members are able to practice public accounting. This experience offers important insight for the regulatory design issues embedded in my mandate. In the final part of this interim report, I canvass two regulatory models that I believe are worthy of further attention for Ontario. My discussion of these models identifies several design issues for further consideration.

Before proceeding, I wish to acknowledge the invaluable advice and counsel of Mr. John Leddy, of the law firm of Osler, Hoskin & Harcourt LLP. I retained Mr. Leddy to assist me in my consultations with various stakeholders, and to be able to understand fully the legal and regulatory context pertaining to the accounting profession in Ontario and beyond.

I also want to express my appreciation to each of you and to your organizations for the information and support you have extended to me in my deliberations. The

Province of Ontario is fortunate to have an accounting profession that is so firmly committed to the highest ideals of the profession and to the public interest.

1. PUBLIC ACCOUNTING REGULATION IN ONTARIO

(a) The Rationale for, and Structure of, Accounting Regulation

The purpose of accounting regulation is to ensure that the public has access to high quality accounting services. Regulation is necessary because consumers of accounting services ("second parties") or others who come to rely on these services in the course of their business or investing activities ("third parties") may not be able to gauge the individual credentials, expertise, and ethics of the professional who provided the advice or service in question. As a consequence of a lack of reliable information (or an inability to assimilate such information), second and third parties may make important financial or investment decisions that are based on erroneous or flawed accounting data. And although individuals and firms engaged in accounting practice can develop public reputations that assist second and third parties in making informed choices, these strategies are not fully responsive to the concern that members of the public will, in the absence of regulation (including civil liability), consume services from unreliable or low quality providers.

The Province's regulatory model for accountants is based on a mixture of certification (a signal of quality that is conferred by a self-regulatory organization but not accompanied by a prohibition on service delivery by non-certified providers) and licensure elements (only licensed holders are able to deliver services). At its core, the model is predicated on the idea that the profession should be imbued with the responsibility for self-regulation in the public interest. In the context of professional self-regulation, the public interest is proxy for consumer interest in purchasing high quality, competitive, accounting services. Enlightened self-regulation permits the public to benefit from the expertise and experience of accountants in the design and implementation of regulatory institutions and rules, while maintaining public trust and confidence in the accounting profession. However, in designing self-regulatory models, policy-makers need to be attentive to the prospect that regulated professionals may utilize self-regulation to erect unwarranted restrictions on entry into, or conduct within, the profession that have the effect of lessening competition, and protecting supplier rather than consumer interests.

Like other professional self-regulatory models, accounting regulation in the Province of Ontario utilizes a combination of input and output based instruments that has, by and large, been developed and implemented by the Institute of Chartered Accountants of Ontario (the "ICAO"), the Certified General Accountants Association of Ontario (the "CGAAO") and the Society of Management Accountants of Ontario (the "SMAO") in respect of their members. Input regulation seeks to ensure that individuals practicing accounting have the requisite knowledge, skill and ethics to be able to provide high quality services to the public, whereas output regulation operates after an individual has been certified for practice, and takes the form of various obligations governing professional conduct, standards of practice, and continuing education.

In Ontario, the government has statutorily reserved the designations of CA, CGA and CMA to, respectively, the ICAO, CGAAO and SMAO (collectively, the "Designated Bodies")[1], which can only confer these distinctions on individuals who have satisfied their various entry requirements (expressed in terms of pre-professional training, work experience, and successful passage of a comprehensive set of exams) and who agree to adhere to ongoing conduct requirements. Accreditation thus serves as a signal of quality that assists the public in discerning the level of expertise of an accounting professional. To ensure that the designations granted by the Designated Bodies fulfill their function of assuring the public of the quality of the professionals holding the titles, each of the Designated Bodies has developed extensive regulatory capabilities.

Admission to the practice of public accounting is a licensed activity under the purview of the Public Accountants Council (the "PAC") which was established by the *Public Accountancy Act* in 1950 (the "PAA 1950"). Initially, the PAC was to be composed of eight appointees of the ICAO, five appointees of The Certified Public Accountants Association of Ontario (the "CPAAO") and two individuals, who were not members of the ICAO or CPAAO, elected by persons licensed under the PAA 1950. Under the PAA 1950, an applicant was entitled to be licensed as a public accountant if he or she: (a) was a member of the ICAO or CPAAO (having satisfied the course-work and examination requirements of either body), or passed a separate examination (determined by the PAC to be at least equivalent to the intermediate examination of the ICAO or CPAAO); and (b) practiced public accountancy in Ontario for a period of not less than three years.

Significant amendments to the PAA 1950 were passed in 1962 (as amended, the "PAA 1962"). These amendments introduced, among other things, a more detailed definition of "public accountant" emphasizing the independence and expertise of the licensee. Other noteworthy changes to the regulatory regime introduced under the PAA 1962 included: (a) the designation of the ICAO as the sole qualifying body of public accountants in the Province (the ICAO and the CPAAO merged prior to the enactment of the PAA 1962); (b) a change in qualifying standards (an applicant was entitled to be licensed if he or she was a member of the ICAO and the PAC was satisfied that he or she was of good character); and (c) a change in the composition of the PAC, which would be (and is still) made up of twelve individuals appointed by the ICAO and three individuals elected by public accountant licensees who were not members of ICAO.

The PAA 1962 also included grandparenting provisions which provided that a person was entitled to a license if he or she had at any time been licensed as a public accountant under any predecessor legislation or was a member of the CGAAO and met certain other specified requirements. After 1962, membership in the ICAO effectively became the qualifying standard applicable to the practice of public accounting in the Province.

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[1] The ICAO, CGAAO and SMAO derive their authority from, respectively, *The Chartered Accountants Act, 1956* (Ontario), as amended, *An Act respecting the Certified General Accountants Association of Ontario* (Ontario), as amended, and the *Society of Management Accountants of Ontario Act, 1981* (Ontario), as amended.

Amendments made to the *Public Accountancy Act* (as amended to the date of this report, the "PAA") after 1962, and prior to the amendments introduced by Schedule C to *Justice Statute Law Amendment Act, 2002*, have been rather minor. Indeed, the changes introduced by the PAA 1962 in respect of the definition of "public accountant", the composition of the PAC and the training and education pre-conditions to licensure remain in place today, despite a number of attempts at reform (as outlined below).

Under the current regulatory regime, most of the self-regulatory responsibility for addressing public interest concerns in relation to public accounting is borne by the ICAO. The ICAO bears the ongoing responsibility for setting practice standards, for developing and enforcing ethical codes of conduct, for undertaking practice inspections, and for initiating professional discipline of accountants (various forms of output regulation). At the present time, the PAC's role is largely confined to the issuance of public accounting licenses (the vast majority of which are granted on a non-discretionary basis to ICAO members)[2], for undertaking supplementary discipline proceedings against ICAO members for the purpose of license revocation (based on the evidentiary record and decisions made in discipline proceedings conducted at the ICAO level), and to disciplining non-licensed accountants for unauthorized practice.

(b) **Attempts at Reform**

Over the last several decades, the subject of public accounting regulatory reform has attracted considerable attention from a number of different commentators. By and large, interest in reform has been motivated by concerns over access to the public accounting field by accountants who were not members of the ICAO.

(i) *The Professional Organizations Committee*

In April 1980, The Professional Organization Committee (the "POC"), appointed by the Attorney General for Ontario to review the statutes governing the professions of public accounting, architecture, engineering and law, issued a report that recommended the repeal of the PAA and the abolition of the PAC. In its stead, the POC recommended that the ICAO, CGAAO and SMAO be designated as "reserved title organizations" and given the power to grant public accounting licenses under a new legislative scheme (the scope of the licenses would extend to audit and non-audit reviews). Under the POC recommendations, a candidate presented by the ICAO, CGAAO or SMAO would be entitled to a license if he or she passed a uniform qualifying examination administered by a new Public Accounting Licensing Admission Board (the "PALAB"). The POC also proposed that the administration of the UFE (the comprehensive qualifying exam developed and administered by the ICAO) be transferred to the PALAB. In the absence

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[2] The PAA contains provisions respecting the licensure of non-ICAO members, which have been only infrequently used. Subsection 14(2) provides that the PAC may "in special circumstances" exempt a person from the requirements of subsection 14(1) (which includes the requirement that an applicant be a member of the ICAO). Subsection 14(3) gives the PAC the authority to prescribe terms and conditions under which a person holding a license issued by another province or state may be exempted from the requirements of subsection 14(1).

of such transfer, the PALAB would have the power to set and administer its own licensing examination. The PALAB would also have the power to advise the Lieutenant Governor in Council as to the adequacy of the regulations of the three licensing bodies in respect of entry standards.

The POC also recommended that the PALAB be comprised of thirteen members, three nominated by each of the CGAAO, ICAO, and SMAO; three others, knowledgeable in finance but not members of any of the three accounting organizations, nominated respectively by the Chairman of the Council of Ontario Universities, the Chairman of the Council of Regents for the Colleges of Applied Arts and Technology and the Chairman of the Ontario Securities Commission (the "OSC"); and a chairman, who was not a member of any of the three accounting organizations, nominated by the Lieutenant Governor in Council.

(ii) *The Wolff Report*

In April 1993, the Attorney General for Ontario commissioned a review of the regulation of public accounting in Ontario. The review was conducted by Professor Roger Wolff, then of the University of Toronto, in consultation with a committee composed of key suppliers and users of accounting services in Ontario. In his report, which was not endorsed unanimously by the consultative committee, Professor Wolff recommended significant reforms to the system with a view to providing reasonable access for CGAAO and SMAO members to the practice of public accounting in Ontario while maintaining high professional standards.

The Wolff report proposed a new definition of "public accounting" which would clearly include within its scope audits, non-audit reviews and the issuance of compilation reports (the latter two functions had become more prevalent since the introduction of the PAA 1962). The report then recommended the implementation of a two-tiered regime of: (a) licensing in respect of assurance-based work (i.e., audit and review activities); and (b) certification in respect of other public accounting activities (e.g., compilation work).

Under Professor Wolff's proposals, the ICAO, CGAAO and SMAO would be named "designated accounting bodies". A person would be required to obtain a certificate issued by a designated accounting body in order to practice non-assurance-based public accounting work. Any member in good standing of a designated accounting body would qualify for a license to perform assurance-based work if he or she passed a qualifying examination set by the Government of Ontario or its agent and satisfied certain educational and practical experience requirements. The Wolff report further recommended that the UFE be designated as the qualifying licensing examination for an interim five-year period, after which its use as a qualifying standard would be evaluated with a view to determining whether candidates presented by the CGAAO or SMAO had been provided equal and fair access to the examination.

Professor Wolff proposed that a "Public Accounting Licensing Board of Ontario" (the "PALB") replace the PAC. The composition of the PALB should be such that members engaged in public accounting always constitute a majority. No single

designated accounting body should ever form a majority on the board. Professor Wolff's view was that a significant level of lay board membership would provide greater protection of the public interest (as compared to a regulatory board controlled by one or more professional accounting bodies). The PALB would have the authority to: (a) grant licenses to practice assurance-based public accounting work; (b) regulate the practice of public accounting in all defined areas; (c) advise the Government of Ontario with respect to regulated and unregulated practice; (d) monitor and advise the Government of Ontario on the quality-assurance programs of the designated accounting bodies; (e) monitor the knowledge, practical experience and ethics standards of the designated accounting bodies; (f) hear complaints from the public regarding unauthorized practice by individuals who are not members of a designated accounting body; (g) hear complaints made by unsatisfied members of the public in respect of certificate or license holders (following a review of the issue by the complaints committee of the relevant designated accounting body); and (h) suggest legislative amendments to the Government of Ontario.

Touching on the theme of interprovincial mobility and emphasizing the importance of fair treatment for individuals from outside of Ontario wishing to practice assurance-based public accounting in the Province, Professor Wolff also proposed that licenses be granted to an applicant from outside Ontario if he or she is a member in good standing of a designated accounting body, satisfies certain work experience requirements and passes the qualifying exam.

(c) **Other Events**

(i) *AIT Panel*

In 2001, a panel was established under provisions of the *Agreement on Internal Trade* (the "AIT") to review a complaint made by the Certified General Accountants Association of Manitoba that the PAA and the administration thereof are inconsistent with the Labour Mobility Chapter of the AIT, the purpose of which is "to enable any worker qualified for an occupation in the territory of a Party to be granted access to employment opportunities in that occupation in the territory of any other Party."

In its report, the AIT panel highlighted several aspects of the Ontario regime which do not comply with the AIT. The panel focussed especially on subsections 14(2) and 14(3) of the PAA. The panel found that the phrase "special circumstances" included in subsection 14(2) has been interpreted and applied by the PAC in such a restrictive manner that the assessment of qualifications of an applicant is not based principally on competence. The panel also concluded that subsection 14(3) is too restrictive in that it excludes the recognition of potentially qualified public accountants practising in a jurisdiction that has chosen to recognize competency by some way other than licensing. The panel further noted that the objective assessment of the competencies of applicants from other jurisdictions who are not chartered accountants is significantly constrained by the current ICAO–dominated composition of the PAC and the fact that the PAC does not have much flexibility under the PAA to recognize public accountants from other jurisdictions.

(ii) *Report of the Red Tape Commission*

On December 10, 2001, the Red Tape Commission of Ontario (the "Commission") issued a report to the Attorney General recommending a substantial revision of the PAA on the ground that the current licensure system unfairly restricts competition. In its report, as outlined in more detail below, the Commission concluded that there was a need for a clearer definition of "public accounting", recommended new qualifications for licensure and delineated a new scheme for the on-going regulation of the practice in the Province.

The Commission recommended that a new definition of "public accounting" be adopted which more narrowly defines the activities that are within its scope (the Commission did not suggest new wording). The new definition should allow accountants, and the firms in which they work, to know when they are engaged in public accounting work that is restricted to licensees.

The Commission also recommended that all potential licensees be required to pass a common qualifying exam which, together with common continuing education requirements, would establish a single uniform high standard of knowledge and expertise required of those who wish to practice public accounting in the Province.

The Commission proposed that, for an interim period, permission to write the qualifying exam be restricted to members of the ICAO, CGAAO and SMAO. This restriction would be dropped once a new governing body established a uniform qualifying standard. With a view to ensuring equal access to the practice, the new qualifying standards should allow for an assessment of the eligibility of applicants from other jurisdictions to write the qualifying exam (without membership in an accounting organization).

Based on its view that the establishment of public accounting standards and the testing of applicants against such standards should not be controlled by the professional accounting bodies, the Commission recommended the creation of a new regulatory body initially composed of a significant number of public representatives, along with representatives from each major accounting association. The Commission recommended that the new regulatory body, which would have the power to grant and revoke licenses (and impose other disciplinary sanctions), make recommendations within one year of its constitution relating to, among other things, a new definition of public accounting, the standards that ought to be applied to public accountant licensees, the coordination of the review and inspection functions performed by the new regulatory body and the existing accounting bodies, and the content of an appropriate "Notice to Management" which would notify a reader if the work product was prepared by a non-licensee.

(d) **Justice Statute Law Amendment Act, 2002**

Schedule C to *Justice Statute Law Amendment Act, 2002* (the "Justice Act"), which has been passed by the Provincial Legislature but not yet been proclaimed in force, introduces a number of important amendments to the PAA that will have a significant

impact on the regulation of public accounting in the Province. For example, the Justice Act will amend subsection 14(1) such that a member of the ICAO, CGAAO or SMAO will be entitled to a public accounting license if he or she passes a qualifying examination set by the PAC (or an equivalent examination prescribed by the Lieutenant Governor in Council in consultation with the PAC). In addition, the Justice Act provides that the composition of the PAC shall be established by regulations made by the Lieutenant Governor in Council. The Lieutenant Governor in Council may also prescribe, by regulation, functions for the PAC in addition to those already set forth in the PAA.

The Justice Act also gives the Lieutenant Governor in Council the power to set or revise post-entry standards and provides that a public accountant license may be revoked if an inquiry undertaken by the PAC finds that the license holder failed to comply with any new conditions prescribed by the Lieutenant Governor in Council.

(e) **Concluding Comments**

Writing in 1980, The Ontario Professional Organizations Committee characterized the history of the regulation of the accounting profession in Ontario as one of "recurring outbursts of organizational rivalry and recurring attempts to snatch harmony from the jaws of discord" (at 125). Events over the last decade reveal a disquieting persistence of this pattern of rivalrous and fractious interaction punctuated by several spasms of well-intentioned, though ultimately ill-fated, reform.

Yet, despite this history of policy paralysis (at least until the recent legislative amendments), it is worth noting the extent to which several different independent reviews of the system of public accounting regulation in the Province have converged on several key points. First, that members of the CGAAO and SMAO are accomplished and skilled accounting professionals, and should have access to the public accounting field on terms that are more liberal than those that were in force prior to the recent amendments. Second, that there is a need for substantial amendments to the composition, mandate and operations of the PAC if it is to enjoy appropriate independence, transparency and regulatory legitimacy. Third, that the new public accounting regime should, to the extent possible, seek to utilize the self-regulatory expertise and experience of the existing Designated Bodies. Fourth, that individuals who are currently licensed as public accountants should not be subject to unnecessary and burdensome obligations in order to transfer to the new regime.

However, as against these broad areas of agreement, the various policy reviews reveal fundamental differences in respect of the appropriate ambit of public accounting, the appropriate boundary lines between licensed and unlicensed activities, and the character of the exam(s) used to determine admission to the field of public accounting (however defined).

2. REGULATION IN OTHER JURISDICTIONS

In this section, I review the regulatory experience of six representative jurisdictions (Alberta, British Columbia, Newfoundland and Labrador, Nova Scotia, the United Kingdom and Australia) that permit more than one accounting body to certify individuals for accounting practice (based on different qualifying regimes). In developing these reviews, I contacted regulators or other stakeholders in these jurisdictions to gain some appreciation of their experience with various regulatory structures. Set forth below is a summary of what I took to be the more instructive structural and experiential elements of these regimes. A table comparing certain relevant components of the regulatory regimes in place in the provinces and territories of Canada is attached as Appendix A.

(a) Alberta

In the Province of Alberta, only members of the Institute of Chartered Accountants of Alberta (the "ICAA"), the Certified General Accountants' Association of Alberta (the "CGAAA") or the Society of Management Accountants of Alberta (the "SMAA") may perform "exclusive accounting practice" work (audit and review work). The accounting bodies have control (delegated by statute) over entry into, and continued practice within, these exclusive fields (other types of accounting work are not publicly regulated in Alberta). It is my understanding that the entry regime for CAs and CGAs is essentially similar to the regime operated by each of these organizations in Ontario (namely similar licensing exams, pre-professional qualifications, professional education, and work experience). A separate body, the Practice Review Policy Board (the "PRPB"), made up of representatives from the three accounting bodies, plays a relatively minor role (as compared to the accounting bodies themselves) in setting standards applicable to the conduct by the accounting bodies of practice inspections. In addition, the Alberta Securities Commission requires that a person submitting an auditor's report pursuant to the *Securities Act* (Alberta) or the *Franchises Act* (Alberta) be a member in good standing of one of the three main accounting organizations, be registered as an exclusive accounting practitioner, and satisfy any additional requirements relating to public company audit work which are prescribed and administered by the accounting body.

The practice of public accounting in Alberta was completely unregulated until 1988, when the Provincial government introduced the above-described exclusive practice restrictions and established a Joint Standards Directorate (the "JSD"). The JSD had a somewhat broader regulatory scope that the current PRPB, although it too was principally focussed on practice inspections. In 2001, the scope of the oversight responsibilities discharged by the joint oversight body (the JSD was abolished in 2001 and replaced by the PRPB) was narrowed to focus exclusively on practice inspection oversight.

The most instructive elements of the Alberta experience are that the three professional accounting bodies have been able to productively co-exist and cooperate in certain limited areas under a regime where most of the regulatory powers remain vested within the professional organizations and where the common oversight board (the PRPB,

which I note does not include any public representation and therefore cannot be referred to as a public oversight board) plays a relatively minor role. I also note with interest the apparent lack of any demonstrated detriment suffered by the Alberta public as a result of the open nature of the market for public accounting services in the province. Market forces, buttressed by reputational signals, appear to play the most important role in determining the allocation of public accounting work in Alberta as between the members of the three professional organizations.

(b) **British Columbia**

With the exception of public company audit work, public accounting is unregulated in British Columbia (although a member of one of the three professional accounting organizations, each of which has statutory self-regulating authority, is subject to the rules and regulations of the organization to which he or she belongs). The *Company Act* (British Columbia) restricts public company auditing to members of the Canadian Institute of Chartered Accountants (the "CICA") or the Certified General Accountants Association of British Columbia (the "CGAABC"), and individuals certified by an Auditor Certification Board (the "ACB"). The ACB is comprised of one CICA member, one CGAABC member, one member of the Society of Management Accountants of British Columbia, and not more than two other persons (all board members are appointed by the Lieutenant Governor in Council). Based on my conversation with the Secretary of the ACB, who discharges this function as part of his B.C. Ministry of Finance employment duties, I understand that the board plays no role in the regulation or oversight of post-entry professional standards. Its role is limited to the consideration of applications from non-CAs/CGAs for public company auditor certification.

Like Alberta, British Columbia has therefore developed a more market-based approach to the regulation of public accounting. CA and CGA firms compete for audit work (my understanding is that CGA firms are quite active in the private company and smaller public company audit markets). As has been the experience in the other jurisdictions which have little or no regulation of the accounting profession (apart from the regulatory role played by the self-regulating organizations), there is no evidence that the public has been harmed as a result of this light-handed regulatory approach.

(c) **Newfoundland and Labrador**

The practice of public accounting in the province of Newfoundland and Labrador is subject to licensure by the Public Accountants Licensing Board (the "PALB"). Until 1996, the PALB consisted of five members appointed by the Institute of Chartered Accountants of Newfoundland, one public accountant who was not a member of the Institute and a chair who was a member of the Law Society of Newfoundland. It operated, in the words of its current Chair, "largely as an extension of the Institute of Chartered Accountants of Newfoundland"[3]. Members of the Institute were automatically

[3] Report of Dr. Alex Faseruk, Chair of the Public Accountants Licensing Board of Newfoundland, dated March 31, 2000 and submitted to the Honourable James Flaherty.

entitled to public accounting licenses. The PALB had a discretion to consider applications made by non-chartered accountants (although such licenses were rarely issued).

In response to a legislative committee which recommended greater access to the practice of public accounting, a significant reform of the licensure regime was implemented in 1996. The composition of the PALB was amended such that it is now comprised of an equal number (three) of representatives of each of the three designated accounting bodies and the public. Licensure remains the responsibility of the PALB, which will issue a public accountant license to any individual who has satisfied the examination and other admission requirements of a designated accounting body (the PALB does not set or administer a uniform exam) and satisfies certain practical experience requirements (listed in Appendix A). The PALB also sets minimum standards relating to certain post-entry requirements (which standards are then enforced by each of the accounting bodies). More recently, the PALB proposed several amendments to the *Public Accountancy Act* (Newfoundland), one of which would extend its licensing jurisdiction to review work. Its jurisdiction currently extends to audit work; other types of public accounting work are unregulated in the Province.

The PALB demonstrates that a licensure body with equal representation from the three accounting bodies is capable of carrying out its mandate with a spirit of cooperation and common purpose (the protection of the public). The fact that this regime recently replaced one that had effectively been dominated by the Institute is especially noteworthy and relevant. Finally, I highlight the comments made to me by the current chair of the PALB (Dr. Alex Faseruk) to the effect that, in his view, the public is much better served under the current model in that consumers have been granted greater access to licensed services without sacrificing the high standards under which these services are carried out. In this regard, Dr. Faseruk noted that the PALB has not received any complaints regarding the quality of work provided, or the level of professionalism demonstrated, by any member of the two accounting bodies which were granted greater access to the market in 1996.

(d) **Nova Scotia**

An individual who wishes to carry out public accounting in Nova Scotia must be licensed by the Public Accountants Board of Nova Scotia (the "PAB"). The PAB is composed of five members, three of whom are appointed by the Governor in Council and two of whom are appointed by the Institute of Chartered Accountants of Nova Scotia ("ICANS"), although recent practice has been that the three representatives appointed by the Province are Institute members (all five current members of the PAB are chartered accountants).

The PAB recently issued a series of educational and other qualifications required of a license applicant. The new standards clarify the scope of the PAB's licensing jurisdiction through a new interpretation of the statutory definition of "public accountancy", which generally provides that any assurance work performed by an external accountant, including review work, is a licensed activity. Compilation

engagements, in which the reader draws no assurance, continue to be outside the definition.

In addition, the standards provide that a member in good standing of ICANS, the Certified General Accountants Association of Nova Scotia (the "CGAANS") or the Society of Management Accountants of Nova Scotia (the "SMANS") is eligible for licensure (although CGAANS and SMANS members are required to satisfy special pre-licensure advanced auditing requirements). An applicant must also, among other requirements, satisfy the board that the accounting body to which he or she belongs: (a) requires that practice inspections of its members in public practice be conducted at least once every four years; (b) has a prescribed code of professional conduct (the interpretation document which is attached to the new standards includes a list of principles upon which the rules of professional conduct of an accounting body should be based); (c) has disciplinary procedures which deal specifically with members engaged in public practice; (d) has a governance structure which includes public representation on committees that have a public interest focus; (e) has regulations which specify that the professional practice standards are GAAP and GAAS; (f) has mandatory requirements regarding professional liability insurance; and (g) requires that its members participate in professional development programs. All applicants are required to satisfy uniform practical work experience (listed in Appendix A).

The new standards are intended to add more objectivity and clarity to the procedure followed by the PAB, which previously had discretionary power to determine who was or was not qualified to carry out public accounting in the Province.[4] Certain stakeholders argued that the combination of this broad licensing authority and an Institute-dominated PAB resulted in a system of licensure which unfairly favoured ICANS members.

Several aspects of the regulatory regime in place in Nova Scotia, especially elements of the recently released qualification guidelines, are relevant to the development of reform in Ontario. The indirect approach of the PAB in regulating continuing standards through its regulation of entry standards (by, for example, restricting licensure to members of those designated bodies which put in place post-entry standards, relating to the frequency of practice inspections, governance structures, the content of professional conduct rules and disciplinary procedures), appears to be an effective approach which avoids significant regulatory duplication. It is noteworthy that the statutory composition of the PAB, which does not require representation from the CGAANS or the SMANS, has been left unchanged, raising legitimate concerns over the governance of the board from the perspective of non-ICANs members.

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[4] Prior to the introduction of the new standards, the PAB issued public accounting licenses to a member of ICANS if he or she passed the UFE and had two years of public accounting experience (satisfactory to the PAB). The PAB also issued licenses to non-ICANS members if the applicant had: (a) a college or university degree; and (b) two years of public accounting experience (satisfactory to the PAB). Alternatively, the PAB issued licenses to non-ICANS members if the applicant: (a) satisfied the PAB that he or she had the necessary preliminary education, training and experience; and (b) passed such examinations as were from time to time set or approved by ICANS.

(e) United Kingdom

The regulatory framework in the United Kingdom has evolved significantly over the past fifteen years. *The Companies Act 1989* (the "Companies Act 1989") introduced a statutory regime for the regulation of company audits (*The Companies Act 1985* requires that every U.K. company, except for small or dormant companies, appoint an auditor or auditors; most other accounting activities are unregulated[5]). Prior to the introduction of the Companies Act 1989, any individual possessing a recognized accounting qualification and practice certificate was permitted to perform a company audit in the country.

Under the current U.K. regime, certain "recognized qualifying bodies"[6] ("RQBs") and "recognized supervisory bodies"[7] ("RSBs") regulate admission into the statutory audit field and the on-going conduct of statutory auditors. These organizations have clearly established self-regulatory mandates and enjoy delegated responsibility from the state in determining their own pre and post admission standards (which are separate and different from one another).

An RQB is a body that has the power to enforce rules relating to: (a) admission to or expulsion from a course of study leading to a qualification: (b) the award or deprivation of a qualification; and (c) the approval of a person for the purposes of giving practical training or the withdrawal of such approval. Each RQB administers its own program of theoretical instruction, examination, practical training and professional experience. The entry program of each RQB must be pre-approved by the Department of Trade and Industry (the "DTI"). The current qualifying regime does not include a uniform examination. There are five distinct qualification structures an individual could select from in order to become a statutory auditor in the UK. After completing the qualification process, an individual must register with one of the RSBs. An RSB maintains and enforces rules regarding: (a) the eligibility of persons to seek appointment as company auditors; and (b) the conduct of company audit work. Each RSB develops, sets and enforces its own ethical guidelines (i.e., there are five separate disciplinary procedures). There are some collaborative arrangements between the CA bodies with respect to ethics.[8] Major frauds and scandals are also investigated by the DTI.

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[5] Accountants in the United Kingdom who carry out insolvency and investment business work are subject to additional regulation.

[6] There are currently five recognized qualifying bodies in the United Kingdom: the Association of Chartered Certified Accountants (the "ACCA"), the Institute of Chartered Accountants of England and Wales (the "ICAEW"), the Institute of Chartered Accountants of Ireland (the "ICAI"), the Institute of Chartered Accountants of Scotland (the "ICAS") and the Association of International Accountants.

[7] There are currently five recognized supervisory bodies in the United Kingdom: the ACCA, ICAEW, ICAI, ICAS and Association of Authorized Public Accountants.

[8] The ICAEW, ICAS and ICAS are members of the Chartered Accountants Joint Ethics Committee, which reviews and maintains professional ethics. The ICAS and ICAEW are also parties to the Joint Disciplinary

More recent developments have introduced an additional layer of oversight of the regulatory activities performed by the professional accounting bodies, especially as such activities relate to audit work performed for "public interest" entities (such as publicly listed companies and pension funds). The "Accountancy Foundation" was established in 2001 in response to a Labour Party commitment to provide for more independent oversight of the profession. Through its subsidiary boards (which are all composed of a majority of non-practicing accountants), the Foundation oversees the administration by the various RQBs and RSBs of entry and continuing standards. Because the Foundation is not statutorily-based, professional accounting bodies in the U.K. voluntarily agree to become members and can accept or reject any recommendations for reform made thereby.

A recently-completed review undertaken by the DTI recommended several changes intended to improve the independence of the public oversight regime and deal with concerns regarding the complexity of the Foundation structure. The DTI report recommended that the functions of the Foundation be transferred to another private body, the Financial Reporting Council (the "FRC") which would have three clear areas of regulatory responsibility: (a) the setting of accounting and auditing standards; (b) the enforcement and monitoring of such standards and (c) the oversight of the major professional accountancy bodies. The composition of the FRC and its subsidiary boards should demonstrate a strong commitment to the principle of lay majorities. The report also recommends that responsibility for the monitoring of "public interest company"[9] audits be transferred to a new independent inspection unit of the FRC, leaving the monitoring of non-public interest company audits to the professional accounting bodies. An Investigation and Discipline Board of the FRC should have the statutory (rather than contractual) authority to carry out the investigation and discipline functions in respect of public interest cases (these responsibilities are currently carried out by the professional accounting bodies). My understanding is that the recommendations have been accepted by the Minister and will be forwarded to an implementation committee.

The most instructive elements of the U.K. oversight regime are its narrow focus on statutory audit work performed for public interest entities, and the recent changes and proposed changes to the regime which reflect a commitment to an oversight body which is more independent of the professional accounting organizations. As noted above, there is no independent public oversight body monitoring the regulation of non-statutory audit or other public accounting work (nor, according to a DTI representative with whom I spoke, is there any current public or industry pressure to expand the oversight regime in this manner).

Scheme, which investigates public interest cases involving the professional conduct of individuals and firms.

[9] "Defined as listed public companies, major charities and pension funds.

(f) Australia

Company audits are "co-regulated" in Australia. All other forms of public accounting work are unregulated in the country. Only persons who are registered company auditors may sign audit reports. The registration of company auditors is regulated by the Australian Securities and Investments Commission ("ASIC"). An individual seeking registration as a public company auditor must satisfy a series of requirements set and administered by ASIC, which are focussed principally on practical work experience[10], do not require that an applicant pass a qualifying exam, and require that an applicant who is a member of a prescribed accounting body file a letter of accreditation from the body (certifying current membership). The regulatory function performed by ASIC is supplemented by the self-regulating professional accounting associations and other public institutions.[11] This is the basis for describing the Australian regulatory system as one of "co-regulation". A separate body called the Financial Reporting Council (the "FRC") was established in 1999 to provide public oversight of the process for setting accounting standards in Australia. Consistent with international trends, other recent reforms and proposed reforms to the regulatory regime have focussed on improved auditor independence.

The Australian regime is instructive in that it does not provide for separate public oversight of the regulation by the professional organizations of the accounting profession, other than in respect of the setting of accounting standards (which oversight function is fulfilled by the FRC) and in respect of entry into the public company audit field (which function is performed by the securities regulator). The regulation of public accounting in the country is otherwise left to the professional organizations.

3. CRITERIA FOR ASSESSMENT

In this section, I discuss the various criteria that I believe are appropriate for evaluating alternative ways of protecting the public interest in relation to provision of public accounting services. As discussed earlier, the public interest in this policy area is based on the existence of endemic informational asymmetries that undermine the capacity of second and third party users of accounting services to gauge the accuracy and reliability of services provided. This concern is particularly acute given events over the last several years that have, in some circumstances, undermined public confidence in financial statements prepared for several public companies, and which have spawned efforts in a number of industrialized democracies (including Canada) to enhance the integrity of financial reporting.

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[10] For example, an applicant must submit a list of audit firms where he or she has gained his or her audit experience and submit a list of the auditing assignments on which he or she has been assigned (which submissions must show that the applicant has a minimum of 5,175 hours of audit experience, 1,725 of which spent supervising the audit of public companies). An applicant must also file two referees' reports, one of which must be from a registered auditor who has supervised the audit work of the applicant.

[11] For example, the investigation and discipline functions, which could lead to the revocation of a public company audit registration, are performed by the accounting associations and the Companies Auditors & Liquidators Disciplinary Board.

I believe that the following criteria should be invoked to assess the capacity of different regulatory models to vindicate the public interest in relation to public accounting reform:

(a) Efficiency - A three-pronged test of efficiency will be applied to the alternative models for reform:

- Allocative efficiency - greater consumer choice and lower consumer prices within an adequate regulatory regime that mitigates the impact of informational asymmetries. Allocative efficiency is promoted by the creation of regulatory regimes that support informed, rational consumer choice;

- Dynamic efficiency – creation of strong incentives for service innovations on the part of professional suppliers. This requires a regulatory regime that is responsive and innovative; and

- Regulatory efficiency – regulation should be cost-justified, i.e., the costs of regulation should be commensurate with the benefits realized. Implicitly, policy-makers should, to the extent possible, avoid the creation of duplicative, overlapping and confusing regulatory regimes that generate excessive and avoidable costs. In the case of professional self-regulatory regimes, regulatory efficiency requires that the benefits of industry expertise and experience be effectively harnessed in the creation and administration of nuanced, responsive regulation.

(b) Fairness – Any model for the regulation of public accounting should provide for equality of access for any person who is sufficiently qualified to perform the regulated activities. The corollary of this is that no person who is inadequately qualified should be granted access to the market (otherwise the model will be unfair to those who are adequately qualified).

(c) Regulatory transparency, independence and accountability – To ensure public confidence in professional regulation, it is essential that the system of regulation be transparent to the public at large, be accountable to the over-arching public interest in public accounting regulation, and that regulatory decision-making be independent of supplier interests while nevertheless seeking to harness the expertise and experience of regulated professionals in the development of regulation.

(d) Harmonization with evolving national and international accounting standards and regimes - As evidenced by the recent changes and proposed changes to the regulatory regimes in place in the United States[12], the

[12] In the United States, the Public Company Accounting Oversight Board (the "PCAOB") was recently established pursuant to the Sarbanes-Oxley Act (the "SOA") to oversee the audit of public companies that are subject to U.S. securities laws administered by the Securities and Exchange Commission (the "SEC").

United Kingdom and Australia, there is a trend internationally towards a higher degree of regulatory oversight in respect of certain types of public accounting work (i.e., audit work performed for "public-interest" entities such as public companies and pension funds). The creation of the Canadian Public Accountability Board, which will regulate audit work performed for Canadian public companies, is consistent with this trend[13]. Regulatory reform in Ontario should be consistent with national and international trends in public accounting regulation. Furthermore, regulation in Ontario should inasmuch as possible facilitate professional mobility across provincial and international boundaries.

(c) Transition costs - The application of this criterion requires a consideration of the likelihood of a timely and low-cost transition from the current regulatory model to the proposed model. Inasmuch as possible, new regulatory structures and institutions should seek to harness the expertise of existing structures and institutions.

The PCAOB replaces the current system of self-regulation in this area. It is comprised of five members appointed by the SEC after consultation with the Chairman of the Federal Reserve Board and the U.S. Secretary of the Treasury. No more than two of the appointees may be professional accountants. The SEC has oversight and enforcement authority over PCAOB. Generally, the duties of the PCAOB include: (a) the registration of public accounting firms that prepare audit reports for public issuers; and (b) the establishment and enforcement of rules regarding auditing, quality control, ethics, independence and other standards applicable to the preparation of audit reports. The PCAOB's authority does not extend to accounting firms that do not audit public companies. The PCAOB is funded by assessments on public companies with stock traded on U.S. exchanges.

[13] The Canadian Public Accountability Board (the "CPAB") is a joint initiative of the CICA, the Office of the Superintendent of Financial Institutions, the Ontario Securities Commission, the Quebec Securities Commission and the Canadian Securities Administrators. It will be organized as a not-for-profit corporation without share capital under the *Canada Business Corporations Act*. The general mandate of the board will include the (i) setting and enforcement of auditor independence rules, (ii) oversight of Canadian public company auditor inspections, and (iii) setting and enforcement of quality control requirements applicable to Canadian public company auditors. It will be is comprised of eleven members, seven of whom must be from outside the profession. The composition of the CPAB provides for independent control, although the overall independency of the body comes into question given that it will be funded by member firms. It is also my understanding that auditors and audit firms will voluntarily agree to be subject to CPAB standards (auditors and firms will presumably also have the right to withdraw from such regulation). The CPAB will have the ability to impose sanctions on auditors, although it will depend significantly on the provincial self-regulating bodies in respect of the investigatory and discipline functions.

4. ALTERNATIVE MODELS

(a) Overview

The central purpose of this interim paper is to present alternative models for reform. My intent is to generate discussion and feedback from the various stakeholders regarding the relative merits of each model.

With this in mind, I have set out below very general descriptions of two alternative models that I believe are worthy of further attention by the stakeholders for the purpose of my final report to the Province. I have labelled these models:

- the Parallel Licensure Model, and
- the Public Interest Entity Licensure Model.

In developing these models for review and comment by the stakeholders, I want to note that I have given detailed consideration to other prospective models for the regulation of public accounting in the Province, and have determined that they are not appropriate for further consideration in light of their lack of congruence with the criteria developed above.

Specifically, I have reviewed the desirability of a completely uniform or exclusive model of regulation under which all accounting regulatory functions (both public and non-public) would be transferred to a re-constituted PAC, with the result that only one body would regulate the field in the Province (as is the case with lawyers, who are regulated by the Law Society of Upper Canada). Under this model, the Designated Bodies and the PAC would cease to have any regulatory role whatsoever. Although the model has many merits and could be considered an ideal starting point, I rejected it because it ignores the historical evolution of public accounting regulation in Ontario and other contextual considerations (such as that the Provincial government has legislated that all three Designated Bodies shall be entitled to act as qualifying bodies). The practice of public accounting has been regulated in some manner by the Province for more than fifty years. Institutions such as the Designated Bodies have developed sophisticated self-regulating structures during this period. To suggest that these structures should be eliminated is unfair to the Designated Bodies, undermines significant investments that these organizations have made in their collective professional reputations, would marginalize existing regulatory institutions and competencies, and would entail very significant transition costs without demonstrated public benefit.

Similarly, I have considered the desirability of imbuing the PAC with exclusive responsibility for licensure and ongoing regulation of all assurance-based accounting activity (including preparation of compilations, review engagements and audits). Under this model, the PAC would design and administer a standard licensing exam, prescribe pre-professional and professional education requirements, administer practice inspection, and develop and administer professional discipline mechanisms. The PAC might offer several levels of licensure depending on the complexity of assurance work that is being

performed. Nevertheless, I do not pursue this model further for several reasons. First, the model is predicated on a broad role for a re-constituted PAC that, as in the case of the uniform model discussed above, departs liberally from context and history. Second, there is the risk that the broad regulatory powers exercised by the PAC under this model would swamp the regulatory capacity of the Designated Bodies, constraining their capacity and incentive for responsive regulation. Complicated harmonization and coordination issues will cause significant regulatory confusion as to the continuing roles to be played by the PAC and the Designated Bodies. Third, there would be a need for a substantial transfer of existing regulatory mandates and resources from the existing Designated Bodies to the new PAC if it is to have any regulatory legitimacy. The transitional costs of this model would be high. Fourth, not only would such a transfer be costly, but it would also entail a high degree of regulatory entanglement among the Designated Bodies. Finally, the model goes beyond the international trends towards greater regulatory focus on audit work relating to public companies by extending the licensing jurisdiction of the PAC to all assurance-based services, whether performed for private or public entities.

(b) The Character of the Re-constituted PAC

The two models presented below are each predicated on substantial reform of the PAC. Here, I believe that sound regulatory principles require that the board of the PAC be re-constituted by drawing on representation from the membership of each of the Designated Bodies and by increasing the level of participation of independent directors. From a fundamental fairness perspective, a body responsible for the issuance of public accounting licenses to members of three professional organizations or for overview of the Designated Bodies should not be controlled by any one of these organizations, especially where it exercises discretionary authority in performing its mandate. These concerns are particularly acute in a transitional context.

There is significant consensus amongst the affected stakeholders as to the desirability of reforming the composition of the PAC in favour of an enhanced role for CGAAO and SMAO representatives. Nevertheless, considerable debate still exists as to the precise representation that each of these organizations will have on the PAC, the scope for enhanced (and, to my mind, very desirable) increased public participation on the PAC, the role for representatives from other organizations (the Ontario Securities Commission, for instance), and the precise role, mandate and instruments of the re-constituted council.

Questions relating to re-constituted PAC

- Please comment as to an appropriate level of public versus industry (whether from the Designated Bodies or otherwise) representation on the PAC? Should the public representatives form a majority? Should the Chair of the PAC be a public director? What kinds of expertise should public directors have in order to qualify for PAC membership?

- How should the industry representatives be selected (e.g., elected by the Designated Body membership; appointed by the Attorney General)?

- Should there be an equal number of representatives of each Designated Body on a re-constituted PAC? If not, what is an appropriate and principled distribution of representation having regard to the concerns over fairness and regulatory legitimacy described above?

- Should the proportionate public/Designated Body representation on the PAC be replicated on all of its committees?

- Should there be ex-officio representation from the Ontario Securities Commission on the PAC in order to ensure congruence with financial industry reforms being undertaken by that agency?

- Do you agree with the principle forwarded in support of reform in the United Kingdom that the public is best served by an oversight body which is controlled by independents rather than by professional accounting associations?

(c) **Parallel Licensure Model**

(i) *Description of Model*

Under the model, the task of determining who should be entitled to engage in public accounting would be remitted to the Designated Bodies. However, the Designated Bodies would only be able to discharge this role after having its activities and governance structure reviewed by a re-constituted PAC. During this review, the PAC would evaluate the entry and on-going standards of each Designated Body (including entry exams, post-secondary educational requirements, practical work experience requirements, rules of professional conduct, currency requirements, and practice inspection requirements) to determine if such standards are sufficiently high to allow members of the Designated Body to perform public accounting. I would expect that in undertaking this review, the PAC would have due regard to the demonstrated regulatory success of organizations equivalent to the Designated Bodies currently operating in several other provincial jurisdictions.

A Designated Body whose standards are found by the PAC to satisfy the sufficiency test would then have the authority to license its members as public

accountants (without any future direct involvement of the PAC). A Designated Body whose standards are found to be insufficient would have the option of raising its standards (the required changes would be recommended by the PAC after its review) and subjecting itself to an additional review by the PAC. Assuming the revised standards are found to be sufficient, the Designated Body would be granted the authority to license its members as public accountants. As in the case of other provincial and national jurisdictions surveyed above, there is no reason to expect that the Designated Bodies would necessarily opt for one common licensure exam, likely preferring instead to make their own determinations of the sufficiency of their entry standards subject to appropriate oversight by the PAC.

After the completion of the transitional period, all public accounting regulatory functions, including the setting of exams and the performance of the investigation and discipline functions, would be performed by the Designated Bodies. In other words, the current role of the PAC in respect of licensure of members in good standing of the Designated Bodies, of approving transfers of licensed public accountants from other jurisdictions, and of professional discipline that supplements the professional disciplinary activities previously conducted by the ICAO in respect of its members, would end. In this model, once a member of a Designated Body ceases to be a member in good standing of the organization (for instance, at the end of a discipline process), he or she would also automatically lose his or her public accounting license without any further proceedings conducted by the PAC. It may be desirable to prescribe restrictions on the capacity of disciplined members to gain re-admission to public accounting by joining another Designated Body. The PAC will also have to address the status of licensed public accountants who are currently not members of any Designated Body. In any event, the PAC would still be required to play an ongoing role in relation to the prosecution of non-licensed individuals engaging in unauthorized public accounting practice.

One important question to address is whether the PAC should play a more general monitoring role of the Designated Bodies beyond the end of the transition period. The argument in favour of this role is based on the desirability of having the re-constituted PAC play an oversight role in relation to the public accounting regulatory activities of the Designated Bodies. To the extent that an additional tier of public accounting oversight is required, the PAC (with professional representation) could better discharge this role than alternative governmental arrangements lacking such representation. Such a review role would, however, need to be light-handed in order to avoid the concern of overlapping regulatory jurisdiction between the PAC and the Designated Bodies, although a general power to intervene in the affairs of a Designated Body could be reserved in favour of the PAC where such intervention is in the public interest. Under this scenario, the PAC could be vested with responsibility for periodic, systematic review of the conduct of the Designated Bodies (for example, as was suggested in the ICAO in its brief, the PAC would review the standards of each Designated Body at least once every three years in order to ensure that it continues to satisfy high minimum standards). The PAC could also be vested with the responsibility of ensuring that the existing Designated Bodies were admitting all appropriately qualified candidates from other provinces of Canada and other countries to the accounting profession (both public and non-public). Indeed, there may

be circumstances in which the PAC would suggest that government recognize that another accounting organization be recognized as a Designated Body.

To the extent, however, that the Designated Bodies demonstrate clear and unequivocal regulatory competency in relation to public accounting activity, it may be argued that after an appropriate transitional period, an oversight role by the PAC is unwarranted, and undermines regulatory accountability. The argument here relates to the desirability of having crisp lines of accountability. If the public has concerns pertaining to the conduct of a given Designated Body, then the responsibility for addressing these concerns should reside with the governors of the affected body (acting in the public interest), rather than through the episodic reviews conducted by the PAC as an upper-tier regulator.

Following the precedent of several other provincial jurisdictions, a broad definition of public accounting would be utilized under this model, the effect of which would be to limit entry in assurance-based accounting to only those individuals who are licensed by one of the Designated Bodies (which has satisfied the sufficiency test administered by the PAC during the transitional period). "Public accountant" would be defined as a person who either alone or in partnership provides, or offers to provide, the following types of services: (a) services that are necessary or desirable in connection with the performance of an audit or review engagement, which may or may not include the rendering of an opinion or other positive or negative statement by the service provider as to the correctness, fairness, completeness or reasonableness of a financial accounting statement or any statement attached or relating thereto, or (b) compilation services where it can be reasonably expected that all or any portion of the work product prepared by the service provider will be relied upon by a third party. Bookkeeping or other accounting functions performed for management by an employee would be expressly excluded from the definition.

One significant and unresolved design issue that would have to be addressed in relation to this model relates to the ability of a CGAAO or SMAO member to satisfy an entry standard which is predicated in part upon a set level of practical work experience gained under the direction of a public accountant, given that the vast majority of current public accountant licensees in the Province are ICAO members (this concern is common to both models). Although a considerable amount of attention over the years has been dedicated to the issue of whether a common exam is necessary for admission to public accounting (and the character of that exam), too little attention has been devoted to the issue of how members of the CGAAO or SMAO who will be otherwise qualified for public accounting will be able to enter the field in light of the dearth of non-ICAO member based public accounting practices in the Province. It may be possible that in the near term work experience could be garnered (or may already have been) from employment offered by CA firms or from the entry of extra-provincial CGA firms into the Province. However, I am at this stage not convinced that the post-transition demand for public accounting experience by prospective public accountants can be fully satisfied in this manner, and there will be a need to foster creative solutions to this problem if members of the CGAAO and SMAO wishing to enter public accounting practice are to be assured of a fair opportunity to enter the field.

(ii) *Application of Criteria and Comment*

The benefits of such a model are clear. By vesting responsibility for public accounting regulation in existing organizations, the barriers to entry into the public accounting field by the members of the Designated Bodies would be significantly reduced. Providing that such entry is responsive to the public interest in ensuring high quality service provision, efficiency gains from increased supplier competition should result. The model seeks to protect the public interest by requiring that each Designated Body demonstrate to the PAC (during the transitional period) and then to the public that it has in place the regulatory mechanisms which are necessary and appropriate in light of the important function carried out by public accountants. In the case of the ICAO, that body is already discharging the role as the *de facto* regulator of the public accounting activities of its members. In the absence of any demonstrated deficiency in the current institutional arrangements (as amended by the introduction of CPAB), it is likely that ICAO would satisfy the sufficiency test without any significant changes to its structure. In the case of the CGAAO and the SMAO, the claim in favour of this model is not that their existing regulatory activities (both entry and conduct based) are necessarily adequate to the task of regulating their members' public accounting activities in the public interest (this determination would be made by the re-constituted PAC), only that if vested with the responsibility of serving as the principal regulator of the public accounting activities of their members, these organizations possess the innate capacity to develop regulatory strategies that effectively vindicate the public interest. It is also important to note that uniformity of substantive service-related standards is already in place in the Province in that members of the Designated Bodies are required to perform services in accordance with generally accepted accounting principles and, where applicable, generally accepted auditing standards.

Under this model, each Designated Body would, by and large, be responsible for the integrity of its self-regulatory regime (subject to the sufficiency test administered by the re-constituted PAC). Consequently, the model minimizes the scope for regulatory coordination, and eliminates the scope for duplicative regulation. The duplication of functions, for instance, that now exists between the ICAO and the PAC in terms of qualification and discipline activity for licensed members would be eliminated, thereby reducing overall regulatory cost to members and the public, and increasing regulatory accountability. This model can also be viewed as more conducive than the other model to the promotion of regulatory innovation on the part of the Designated Bodies. Another virtue of the model is its preservation of the distinct reputations and regulatory capacity of the Designated Bodies. The model also has the strength of rough consistency with the models adopted in a number of Canadian provincial jurisdictions, and is therefore conducive to heightened inter-provincial mobility of public accountants. The Designated Bodies would, under this model, be charged with the task of determining whether a public accountant from another province or country could enter the public accounting field in Ontario by becoming a member of that Designated Body and then by securing a license from it. Further, the model minimizes the degree of regulatory entanglement among the various Designated Bodies. Finally, given the use of existing regulatory organizations to regulate entry into, and conduct within, the field of public accounting, the transition costs of this model should be fairly low.

As against these alleged benefits, there may be concerns with the greater scope for "regulatory arbitrage" that exists within in this model. Regulatory arbitrage arises when regulatory organizations will opt for less costly, more lenient, and socially undesirable forms of regulation solely as a means of capturing increased market share for their members at the expense of members of competing, "higher-standard" professional self-regulatory organizations. In this environment of heightened regulatory competition, the fear is that even regulators committed to high professional standards will be unable to maintain this commitment as a result of pressure from segments of their membership seeking to operate in a lower cost regulatory environment[14]. Nevertheless, one can expect that several factors would attenuate any innate propensity on the part of Designated Bodies towards unwarranted regulatory leniency, including: the role of public representatives on the governance bodies of the Designated Bodies, the sufficiency test and perhaps ongoing review administered by the PAC, the commitment shared by each of the Designated Bodies to GAAP and GAAS, and pressure exerted from the public and other regulatory agencies (e.g., the OSC and CPAB) for the highest appropriate standards of regulation.

(iii) *Related Questions*

- Are the current entry and on-going standards of the three Designated Bodies sufficient to provide adequate assurance to the public that the members of each body are currently qualified for licensure as public accountants? If not, what modifications in relation to the entry standards (particularly in relation to work experience and entry examination) are appropriate to ensure that the public interest is adequately protected?

- How can the public be confident that otherwise qualified members of the CGAAO and the SMAO will be able to secure appropriate work experience in Ontario given the historic exclusion of these organizations from public accounting and the consequent dearth of appropriate supervised practice opportunities?

- Please comment on the proposed definition of "public accountant". Should the definition be limited to the provision of compilation, review or audit services, where the work product delivered by the individual is for third party-use (as has been suggested by the SMAO)?

[14] Indeed, even if regulatory autonomy does not result in a destructive race to the bottom, members of certain Designated Bodies may still fear the reputational consequences to the accounting industry as a whole (and to other Designated Bodies in particular) from flawed regulatory decisions made by one Designated Body. The prospect of inconsistent application by the different Designated Bodies of on-going standards (e.g., lighter sanctions imposed in respect of same of similar misconduct by a member) would also have reputational consequences and result in a misallocation of members (i.e., away from the Designated Bodies which interpret standards on a more stringent and principled basis).

- Do you think it would be necessary to keep the PAC in place after the completion of the transitional period? What additional value would it add to the regulatory process? One example of a role which could be fulfilled by the PAC (as was suggested by the CGAAO) is the maintenance of an express set of guidelines for the evaluation of the equivalency of work and other experience qualifications of an out-of-province applicant (which guidelines are currently being developed by the PAC). Please comment as to the possible content of such guidelines.

- Assuming that it were to remain in place after the completion of the transitional period, what residual role (if any) should the PAC play in supervising the Designated Bodies? In what clearly defined circumstances should the PAC have the jurisdiction to intervene in the affairs of a Designated Body "in the public interest"? Should the PAC have the capacity to supplant the role of the Designated Bodies in relation to professional discipline activities normally conducted by those bodies?

(d) Public Interest Entity Licensure Model

(i) *Description of Model*

Under this model, the Province would distinguish public accounting work performed for "Public-Interest Entities" (to be defined to include entities such as public companies, mutual funds and pension funds) from public accounting work performed for non-Public Interest Entities. The former would be regulated by the re-constituted PAC, while the latter would be regulated by the Designated Bodies in a manner discussed above based on parallel licensure . The rationale for segmenting Public Interest Entity accounting activity from non-Public Interest Entity accounting activity is based on the greater risks to the public interest that emanate from professional failure in Public Interest Entity activity. Because Public Interest Entities are subject to accountability problems (meaning that managers may undertake actions not in the best interest of their principals), the scope for abusive accounting practices is arguably greater than is typically the case of privately-held companies. These concerns are buttressed by the risk that accounting failure of one public entity may infect the reputations of other public entities (the "contagion effect"). For this reason, regulators in several industrialized democracies have recently and quite understandably focussed their accounting policy reform efforts on services provided to Public Interest Entities.

The model would operate in the following manner. The PAC would be responsible for determining whether the entry and post-entry standards of each Designated Body were sufficient to allow it to license the members of these organizations as entitled to perform public accounting for non-Public Interest Entities. "Public Accountant" would be defined as described above under the Parallel Licensure Model. Designated Bodies with current standards that are found to be insufficient would have the opportunity to raise its standards. After the completion of the transitional period, all regulatory functions relating to this segment of the public accounting field would be performed by the Designated Bodies.

No licensed member of a Designated Body, however, would be entitled to perform public accounting services (including compilations, reviews and audits) for a Public Interest Entity unless he or she has been granted a separate license by the PAC. The PAC would be responsible for setting and enforcing entry and post-entry standards regarding this area of public accounting work. A separate entry exam would likely be one of the pre-conditions to the issuance of a Public Interest Entity license, although the PAC would have the authority to review the qualifying exam of any Designated Body and determine that such exam is sufficient. Common pre-licensure practical work experience requirements and post-licensure practice inspection, professional development and other on-going standards requirements would also be set and enforced by the PAC.

The PAC would have complete jurisdiction with respect to the investigation of any complaints received in respect of a Public Interest Entity licensee, including the power to initiate an investigation in the absence of a public complaint. The PAC would also have jurisdiction with respect to the discipline function (including the holding of hearings and the determination of appropriate penalties imposed on a licensee).

During the transitional period, only persons holding a license granted in accordance with the current PAA would be entitled to perform Public Interest Entity work. During such transitional period, the PAC would be required to:

(a) apply a sufficiency test to the Designated Bodies in order to determine whether such bodies should be entitled to license members as public accountants entitled to perform services for entities other than Public Interest Entities;

(b) define "Public Interest Entity", which definition should include those entities in respect of which the public (e.g. investors and pensioners) has a special interest in ensuring financial statement accuracy and reliability;

(c) set high minimum standards applicable to the entry to the Public Interest Entity field and determine whether the current standards of each Designated Body satisfy such standards; members of a Designated Body with entry standards which are found to be sufficient would be entitled to a license without completing any additional qualifying work; members of a Designated Body with entry standards which are found to be insufficient would be required to (i) pass a separate exam administered by the PAC (the exam should test a set of competencies which the PAC determines a candidate must demonstrate prior to the grant of a tier two license), and (ii) satisfy any other pre-entry requirements set by the PAC (e.g., minimum number of hours worked on a Public Interest Entity file under the direction of a licensee);

(d) set post-entry requirements regarding practice inspection, adherence to rules of conduct and satisfaction of on-going professional development requirements, the enforcement of which would be within the jurisdiction of the PAC;

(e) consider whether such post-entry standards should include a requirement that the licensee remain current in this specialized area (by, for example, certifying annually that he or she has performed a certain amount of Public Interest Entity work during the previous five years) – variations of this type of requirement were included in the briefs that I received from the CGAAO and SMAO;

(f) develop a framework applicable to the investigatory and disciplinary functions to be fulfilled by the PAC; and

(g) work with each Designated Body to put in place a system of coordination in respect of the investigation and disciplinary functions to be performed by the PAC (in order to provide for joint investigations and discipline in respect of any conduct of a licensee that is subject to investigation and discipline by the PAC and a Designated Body), all with a view to minimizing duplication of efforts and providing greater protection of the public - the need for the latter is exemplified by the fact that currently, an individual who has as a result of certain misconduct lost his or her "chartered accountant" designation would still be able to hold him or herself out as a "public accountant" until the PAC's disciplinary process has been completed (revocation proceedings would be initiated by the PAC immediately after the ICAO has decided to revoke the designation and all related appeal rights have been exhausted; such revocation proceedings can, in the more complex cases or where the licensee is intent on dragging out the process for as long as possible, last for a year or more).

(ii) *Application of Criteria and Comment*

The Public Interest Entity Licensure Model is responsive to the growing public concern over accounting failures in the context of public capital markets. The model recognizes that the public interest in public accounting activity is greatest in these contexts, and would create a focussed supplementary regulatory regime to address accounting activity in this area. However, second tier regulation would be tightly confined to Public Interest Entity work, and should not impair the capacity of the Designated Bodies to fashion distinctive regulatory standards in relation to non-Public Interest Entity work performed by members. As a consequence, the benefits of regulatory disentanglement, regulatory innovation, and enhanced competition for non-Public Interest Entity work that are associated with the Parallel Licensure Model would be preserved (at least with respect to the Designated Bodies). The model is clearly consistent with national and international regulatory trends of independent regulation focussed on public company audit work, and would powerfully signal the Province's determination to maintain high standards of investor protection in Ontario without suppressing desirable supplier competition.

As against these benefits, the model does entail additional transition costs (at least compared to the Parallel Licensure Model). As the discussion above indicates, there are a

non-trivial set of design issues that a reconstituted PAC would have to address in order to establish this regime. The model will require significant harmonization between the PAC, and Designated Bodies and other public company regulations (such as the CPAB and the OSC) in order to ensure regulatory coherence. In the absence of such coordination, there is a non-trivial risk of incoherent and confusing regulation. However, even with such coordination, in light of the regulatory oversight of CPAB and the OSC, it is not clear that conferring an oversight role on the PAC in relation to Public Interest Entities is necessary or desirable.

(iii) *Related Questions*

- Please comment as to the distinction made under this model in respect of public accounting work performed for a Public Interest Entity. Is separate regulation of Public Interest Entity work by the PAC necessary in light of the establishment of the CPAB and the oversight role played by the OSC?

- Should the PAC play any continuing role in respect of public accounting work performed for a non-Public Interest Entity?

- Are the current entry and on-going standards of the three Designated Bodies sufficient to provide adequate assurance to the public that the members of each body are currently qualified to perform all non-Public Interest Entity public accounting work?

- Is it necessary that any work product prepared for a non-Public Interest Entity include a "Notice to Reader" identifying the service provider as a member in good standing of the applicable Designated Body? If yes, please comment as to the content of such notice.

- Should a uniform qualifying exam be adopted as a pre-condition to the grant by the PAC of a Public Interest Entity license?

- Please comment on the harmonization efforts necessary to ensure that the PAC's regulation setting and administration activities are coordinated with those of the Designated Bodies.

- Should the work performed by a member of a Designated Body in connection with "Management's Discussion and Analysis" disclosure made by a public company should be a licensed activity (as was suggested by the SMAO in its brief)?

I would appreciate receiving your thoughts on these questions and any other comments you may have regarding the two models. As I hope to release my final report in the early spring, I would appreciate having an opportunity to meet with you and any other interested members of your organization to discuss your provisional thoughts on these matters by the 18th of March.

Yours very truly,

Ronald J. Daniels

cc: The Honourable Norman Sterling
The Attorney General and Minister Responsible for Native Affairs

Mr. R.W. Mikula
The President of the Public Accountants Council
for the Province of Ontario

APPENDIX A

REGULATION OF PUBLIC ACCOUNTING IN OTHER CANADIAN JURISDICTIONS

See attached table.

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
Alberta	statutory restriction (i.e., not licensure) – only members of the three designed accounting bodies may perform audits and review engagements	the Practice Review Policy Board establishes standards applicable to the conduct by the designated accounting bodies of practice inspections; the designated accounting bodies report annually to PRPB regarding the results of their practice reviews	three representatives from each designated accounting body	set by each designated accounting body; the Practice Review Policy Board plays no role	set by each designated accounting body; the Practice Review Policy Board plays no role	set and administered by each designated accounting body; the Practice Review Policy Board plays no role	the practice of public accounting in Alberta was unregulated until 1988; the Alberta Securities Commission requires that an auditor's report submitted in accordance with the Securities Act be prepared by a registered – as a member in good standing of the provincial CA institute, CGA association or CMA associations who is "exclusive accounting practitioner"

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
British Columbia	statutory restriction (i.e., not licensure) – only members of the provincial CA institute and CGA association and other individuals certified by the Auditor Certification Board may perform public company audits	the Auditor Certification Board considers application made by non-CAs/non-CGAs for certification; the ACB plays no role in the setting of standards, the performance of practice inspections or the investigation or discipline of statutory auditors	one representative of each of the provincial CA instituted, CGA association and CMA association and not more than two other persons, all of whom are appointed by the Lieutenant Governor in Council	set by each accounting body; the Auditor Certification Board plays no role	set by each accounting body; the Auditor Certification Board plays no role	set and administered by each accounting body; the Auditor Certification Board plays no role	
Manitoba	the practice of public accounting is unregulated in Manitoba	not applicable	not applicable	not applicable	not applicable	not applicable	subsection 34(3) of the Securities Act provides that unless the Manitoba Securities Commission otherwise directs, certain registrants (e.g., dealers and advisors) under the Act must provide a report of an auditor who is a registered member of the provincial CA institute; in 1996, the Commission directed

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
							that the Director of the Commission be granted the discretion to accept reports from a person other than a member of the Institute
New Brunswick	the practice of public accounting is unregulated in New Brunswick	not applicable	not applicable	not applicable	not applicable	not applicable	
Newfoundland and Labrador	licensure – a member in good standing of one of the three designated accounting bodies will be granted a license to perform public accounting if he or she satisfies certain uniform entry requirements	the Public Accountants Licensing Board has the authority to issue and revoke licenses and sets minimum standards relating to certain on-going requirements	three representatives of each designated accounting body and three non-affiliated public representatives	a degree granted by a recognized university or five years of experience in public accounting	completion of a minimum of thirty months of practical experience in public accounting, including a minimum of 625 chargeable attest hours, under the direct supervision and control of a licensed public accountant	set and administered by each designated accounting body; the board plays no role	
Northwest Territories	the practice of public accounting is not regulated in the Northwest Territories	not applicable	not applicable	not applicable	not applicable	not applicable	

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
Nova Scotia	licensure – a member in good standing of the provincial CA institute is entitled to a license; a member of the provincial CGA or CMA association is entitled to a license upon the satisfaction of advanced auditing course requirements	Public Accountants Board has the power to issue licenses, investigate complaints and suspend or revoke a license	two representatives of the provincial CA institute and three other persons appointed by the Governor-in-Council	baccalaureate degree granted by a recognized university or five years of relevant practical experience	minimum of 2,500 chargeable hours in previous thirty to sixty months, including 625 chargeable audit hours, 625 chargeable assurance hours and 100 chargeable taxation hours	set and administered by each accounting body; the board plays no role	the board has discretionary power to license an applicant who does not satisfy the prescribed entry standards
Nunavut	the practice of public accounting is unregulated in Nunavut	not applicable	not applicable	not applicable	not applicable	not applicable	
Prince Edward Island	statutory restriction (i.e., not licensure) - only members of the provincial CA institute may engage in public accounting	there is no separate (from the provincial CA institute) body regulating the practice of public accounting in P.E.I.	not applicable	set and administered by the provincial CA institute	set and administered by the provincial CA institute	set and administered by the provincial CA institute	
Québec	statutory restriction (i.e., not licensure) – no person may engage in public accounting in Québec unless he or she is a member of the provincial CA	there is no separate (from the provincial CA institute) body regulating the practice of public accounting in Québec	not applicable	set and administered by the provincial CA institute	set and administered by the provincial CA institute	set and administered by the provincial CA institute	

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
	institute; provided however that CGAs and CMAs may audit the accounts of specified entities (e.g., school boards, credit unions and municipalities); CGAs are also statutorily authorized to perform industrial and commercial accounting services (which has been interpreted by the Quebec Court of Appeal to include review engagements but not audits)						
Saskatchewan	the practice of public accounting is unregulated in Saskatchewan	not applicable	not applicable	not applicable	not applicable	not applicable	the Saskatchewan Securities Commission requires that audit services provided to a reporting issuer must be performed by a member in good standing of the provincial CA institute or CGA or

Province/ Territory	General form of regulation	Role of separate regulatory body	Composition of separate regulatory body	Entry standards - educational requirements	Entry standards - practice experience requirements	Entry standards - exam requirement	Other comments
							CMA associations
Yukon	the practice of public accounting is unregulated in Yukon	not applicable	not applicable	not applicable	not applicable	not applicable	